

APPENDIX A

BASELINE BUDGET PROJECTIONS

Baseline budget projections are intended to show the levels of revenues, outlays, and deficits that would occur during the next five years, assuming that budgetary policies remain unchanged. They provide a useful starting point for analyzing the changes in national priorities recommended by the President and their dollar effects on budget totals.

Both the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) prepare baseline budget projections. Under both sets of projections, the federal deficit is estimated to decline from last year's record level of \$221 billion, but to remain well above the targets set by the Balanced Budget Act.

This appendix briefly discusses the budgetary outlook under unchanged policies. A month ago, CBO published its baseline projections for fiscal years 1988 through 1992. Additional information has led CBO to revise its projections slightly. The first section of this appendix summarizes the CBO projections and explains why they have changed. The second section compares CBO's projections with the Administration's own estimates of the budget under unchanged policies. The body of this report highlights the policy changes proposed by the Administration in its 1988 budget by comparing them with the CBO baseline.

THE CBO REVISED BASELINE

Under current budgetary policies, CBO projects that the federal deficit will decline slightly between 1987 and 1988 and more steeply thereafter. By 1992, the deficit in dollar terms should be half as big as in 1987; compared with the gross national product (GNP), it would be only one-third as big. Table A-1 summarizes CBO's projections of federal revenues, outlays, deficits, and debt if current policies continue. These projections are contingent on CBO's assumption of a slight pickup in economic growth from last year's sluggish rate and on continued gradual declines in interest rates. Even though the federal deficit is shrinking under current policies, it still remains stubbornly above the targets set in the Balanced Budget Act. Reaching these targets would require deficit reductions of about \$63 billion in 1988 and about \$100 billion a year from 1989 through 1991.

Annual estimates of federal revenues and outlays often reflect a number of one-time or special factors. In 1987, for example, CBO would project a bigger deficit were it not for planned sales of federal assets, shifts of outlays to adjacent years, and a first-year revenue gain from tax reform. But the deficit's downward trend reflects the underlying dynamics of the federal budget in the absence of policy changes. Revenues are boosted by a

TABLE A-1. BASELINE BUDGET PROJECTIONS (By fiscal year)

	1987	1988	1989	1990	1991	1992
In Billions of Dollars						
Revenues						
Individual						
income	361.3	381.0	412.4	458.4	502.2	546.0
Corporate						
income	100.6	118.5	125.8	137.7	150.5	162.6
Social						
insurance	300.8	329.5	353.3	383.3	412.5	437.8
Other	71.4	71.5	70.5	71.6	73.7	76.0
Total	834.1	900.5	962.0	1,051.0	1,138.9	1,222.5
Outlays						
National						
defense	279.6	290.5	303.4	317.1	332.3	346.9
Entitlements	481.4	511.1	542.5	576.9	616.1	658.2
Nondefense dis-						
cretionary	168.5	188.4	196.9	208.9	215.8	222.4
Net interest	133.6	140.4	146.7	151.5	154.9	153.3
Offsetting						
receipts	-53.1	-59.4	-63.2	-66.6	-70.5	-74.3
Total	1,009.9	1,071.0	1,126.4	1,187.8	1,248.5	1,306.4
Deficit	175.8	170.6	164.4	136.8	109.5	84.0
Debt Held by						
the Public	1,912.8	2,081.3	2,243.5	2,378.4	2,484.8	2,567.9

NOTE: Totals include Social Security, which is off-budget.

(continued)

combination of inflation and real economic growth. Outlays, in contrast, grow only a little faster than inflation in CBO's baseline. Net interest outlays--which contributed so powerfully to spending growth in the early 1980s--are expected to grow much more slowly, because of lower interest rates and smaller deficits.

TABLE A-1. (continued)

	1987	1988	1989	1990	1991	1992
As a Percent of GNP						
Revenues						
Individual						
income	8.2	8.1	8.2	8.5	8.7	8.8
Corporate						
income	2.3	2.5	2.5	2.5	2.6	2.6
Social						
insurance	6.8	7.0	7.0	7.1	7.1	7.1
Other	1.6	1.5	1.4	1.3	1.3	1.2
Total	<u>19.0</u>	<u>19.2</u>	<u>19.1</u>	<u>19.4</u>	<u>19.7</u>	<u>19.8</u>
Outlays						
National						
defense	6.4	6.2	6.0	5.9	5.7	5.6
Entitlements	10.9	10.9	10.8	10.7	10.6	10.6
Nondefense dis-						
cretionary	3.8	4.0	3.9	3.9	3.7	3.6
Net interest	3.0	3.0	2.9	2.8	2.7	2.5
Offsetting						
receipts	<u>-1.2</u>	<u>-1.3</u>	<u>-1.3</u>	<u>-1.2</u>	<u>-1.2</u>	<u>-1.2</u>
Total	<u>23.0</u>	<u>22.8</u>	<u>22.4</u>	<u>22.0</u>	<u>21.6</u>	<u>21.1</u>
Deficit	4.0	3.6	3.3	2.5	1.9	1.4
Debt Held by						
the Public	43.5	44.3	44.6	44.0	42.9	41.5
Memorandum:						
GNP	4,399	4,698	5,033	5,406	5,792	6,186

SOURCE: Congressional Budget Office.

CBO estimates of future federal revenues and spending for entitlement programs--such as Social Security--and of offsetting receipts are based on the assumption that laws now on the statute books remain unchanged. Spending for defense and nondefense discretionary programs--those that are funded through the appropriations process--is estimated by assuming that 1987 appropriations remain constant in real terms (that is, with increases sufficient only to offset inflation). CBO's January 1987 report, *The Economic and Budget Outlook: Fiscal Years 1988-1992*, describes in detail the concepts and assumptions used in the baseline.

During the past month, CBO has revised its baseline budget projections to reflect additional information, much of which became available with the release of the Administration's budget. CBO has not changed the economic assumptions on which its projections are based. In the aggregate, these revisions are small, raising the deficit by an average of \$1 billion a year from 1987 through 1992.

CBO now projects slightly higher revenues under current policies than it did earlier; the revisions amount to \$0.2 billion to \$0.3 billion a year from 1987 through 1989 and \$1 billion to \$2 billion from 1990 through 1992. Several factors account for these revisions. Social Security taxes paid by self-employed taxpayers (SECA taxes) were increased to reflect reduced estimates of allowable deductions taken by the self-employed when computing their tax liability. This revision grows from \$0.4 billion in 1990 to \$1.3 billion in 1992; it does not affect the early years of the projection period. Excise tax revenues were revised, for 1992 only, to reflect extension of taxes for the Hazardous Substance Response Trust Fund (Superfund) at rates in effect on their scheduled expiration date, December 31, 1991. Other small changes and reclassifications increase revenues by \$0.2 billion to \$0.3 billion each year.

CBO also projects somewhat higher outlays than it did one month ago, the net result of revisions to a wide variety of spending categories. CBO now estimates higher outlays for several Farmers Home Administration lending programs, and has increased its estimate of Commodity Credit Corporation (CCC) spending in most years. Spending for international affairs (budget function 150) is higher through 1990 but lower thereafter; this revision comes largely from new assumptions about the guarantee reserve fund, which covers delinquent foreign military sales loans. Under the new projections, some outlays will be lower. Medicare spending in 1988 is expected to be about \$600 million lower. The Congress recently mandated schedules for the timely payment of Medicare claims, which CBO estimated would accelerate outlays in 1988. It now appears, however, that payments are already well within the requirements. Net interest outlays are lower than projected

earlier; greater interest receipts from loans and prepayment penalties are only partly offset by higher borrowing costs necessitated by other revisions.

DIFFERENCES BETWEEN CBO BASELINE AND ADMINISTRATION CURRENT SERVICES PROJECTIONS

Like CBO, the Administration projects how the federal budget would look if current tax and spending policies are continued. Also like CBO, the Administration projects that the deficit will decline as revenue growth surpasses outlay growth. But the baseline projections of the two agencies otherwise contain some significantly different features.

According to the Office of Management and Budget's current services projections, the federal deficit will decline to \$174 billion in 1987, \$150 billion in 1988, and \$78 billion in 1992, assuming no further changes in tax law, no domestic spending changes, and a continuation of the defense build-up. CBO projects a higher deficit than the Administration in all years, especially in 1988. CBO would project still higher deficits if, like the Administration, it assumed that defense appropriations would increase faster than inflation.

Administration and CBO estimates diverge for several reasons: alternative definitions of current policy, contrasting macroeconomic forecasts, and other estimating differences (see Table A-2). Differences between the deficit projections of the two agencies are even larger than they first appear, because the Administration's figures contain built-in spending increases--for defense and a space station--that CBO's do not. CBO's more pessimistic projections stem first and foremost from its less optimistic economic outlook. (Chapter II compares the Administration and CBO economic forecasts.) CBO's estimate of outlays for a wide variety of programs in fiscal year 1988 is also higher than the Administration's. But these non-economic factors have a much smaller effect on the deficit after 1988.

Conceptual differences arise from different interpretations of current policies. Identifying current policies is often straightforward: tax law and some spending programs (such as Social Security), for example, will continue unchanged until lawmakers rewrite their underlying provisions.^{1/} In con-

1. Both CBO and the Administration extend taxes for the Airport and Airway, Highway, and Superfund trust funds at current law rates through 1992 in their current policy projections. These taxes are scheduled to expire before 1992. This assumption better approximates current policy.

trast, many spending programs receive appropriations for only one year at a time. Other programs leave wide latitude to program administrators. (In its January 1987 report, CBO documented in detail the assumptions that it uses wherever current policy requires interpretation.)

Table A-2 shows the important instances in which CBO and OMB define certain current policies differently. Defense spending is a major source

TABLE A-2. MAJOR DIFFERENCES BETWEEN ADMINISTRATION'S AND CBO'S BUDGET PROJECTIONS UNDER CURRENT POLICY (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992
Administration's Current Services Deficit	150	147	126	101	78
Major Policy Differences					
Defense	-8	-9	-14	-18	-23
CCC advance deficiency payments	5	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>
Hospital insurance	1	1	3	5	6
Space station	<u>a/</u>	-1	-1	-2	-1
Civilian agency pay raises	<u>1</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>
Subtotal	<u>-2</u>	<u>-8</u>	<u>-11</u>	<u>-12</u>	<u>-14</u>
Major Economic Differences					
Benefit programs	2	5	8	14	21
Net interest <u>b/</u>	3	5	8	13	18
Revenues	<u>10</u>	<u>10</u>	<u>3</u>	<u>-8</u>	<u>-23</u>
Subtotal	<u>14</u>	<u>19</u>	<u>19</u>	<u>19</u>	<u>17</u>
Other Differences	8	4	<u>a/</u>	-2	<u>a/</u>
Additional Debt Service Costs	<u>1</u>	<u>2</u>	<u>3</u>	<u>3</u>	<u>4</u>
Total Differences	20	18	11	8	6
CBO Baseline Deficit	171	164	137	110	84

SOURCE: Office of Management and Budget and Congressional Budget Office.

a. Less than \$500 million.

b. Effect of higher interest rates only.

of divergence. CBO treats defense and nondefense discretionary programs in exactly the same way: that is, it assumes that annual increases suffice to cover inflation, maintaining appropriations at constant levels in real terms. The Administration departs from this approach in the case of defense. Its current services estimates reflect defense appropriations growth of 3 percent a year over and above inflation. Thus, the Administration's current services estimates for defense outlays exceed CBO's by amounts growing from \$8 billion in 1988 to \$23 billion in 1992.

Another key policy difference between the Administration and CBO concerns the timing of deficiency payments to growers of wheat, feed grains, cotton, and rice. CBO assumes that the Agriculture Department will make some of these payments in advance for crops in 1988 and subsequent years, while the Administration assumes no advance payments. This difference causes CBO's estimate of Commodity Credit Corporation spending in 1988 to be \$4.5 billion higher than the Administration's estimate. Advance deficiency payments were mandated by the Congress for the 1987 crop year, and were paid in three of the four previous years.

Several other major policy differences are shown in Table A-2. For the hospital insurance program, CBO assumes that reimbursement rates will increase after 1988 in keeping with an index measuring price changes for typical goods and services purchased by hospitals. The Administration assumes that reimbursement rates will increase only half as fast as this market basket index. The Administration also plans to slow down reimbursements to Medicare providers; CBO's baseline does not include this policy assumption. In its projections, the Administration includes pay raises for civilian agency government employees of 2 percent in 1988 and 3 percent annually from 1989 through 1992. CBO assumes much larger increases--averaging about five percent a year--to keep pace with projected wage growth for private-sector workers. Finally, the Administration includes full costs for a space station in its current services estimates, while CBO does not.

In the aggregate, these contrasting interpretations of current policy raise the Administration's current services estimates of the deficit above CBO's. As a result, they tend to mask large economic and technical estimating differences. As Table A-2 shows, the dominant differences stem from the two agencies' contrasting economic forecasts. CBO's less optimistic assumptions add about \$15 billion to \$20 billion to the deficit every year. Other estimating differences contribute substantially to the 1988 deficit but less so in later years.



APPENDIX B

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